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S E C R E T SECTION 01 OF 04 BRASILIA 003008

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TAGS: [ECON](#) [PGOV](#) [PREL](#) [EFIN](#) [BR](#) [CU](#)

SUBJECT: BRAZIL - FINANCE MINISTER PALOCCI UNDER FIRE

REF: A. BRASILIA 3001
[B](#). BRASILIA 2951
[C](#). BRASILIA 2237

Classified By: Charge d'Affaires Philip Chicola, reason 1.5 (b) and (d)

[1](#)1. (SBU) Summary and comment: Brazil's Finance Minister, Antonio Palocci, considered by many the anchor of GoB economic policy, has been coming under increasing fire in recent days as new allegations have surfaced that he had a role in illegal fund-raising activities by the ruling PT party and knew of an alleged multi-million dollar campaign contribution from the Cuban government (ref B). Once former presidential Chief of Staff Jose Dirceu is removed from his congressional seat (now a foregone conclusion) the opposition and media spotlight will turn ever more towards the accusations against Palocci. President Lula's Chief of Staff, Dilma Rousseff, a more leftist member of the PT, piled on this week, going public with acerbic criticism of a joint proposal advanced by Palocci and Planning Minister Paulo Bernardo to cap current expenditures and maintain a primary surplus well above the GoB's official 4.25% of GDP target. Palocci has threatened on three occasions to resign if he is called to testify by one of the Parliamentary Commissions (CPIs) investigating the scandals but agreed, under pressure, to appear before the Senate Economic Affairs Committee on November 22, where he might face some questioning about the accusations.

[1](#)2. (SBU) The timing of Rousseff's outburst on fiscal policy was remarkably poor for Palocci, who already was under attack for scandal-related reasons. There is increasing speculation among the political chattering class that Palocci is a goner. Indeed, we can now imagine a confluence of events, both scandal and policy-battle related, that would make Palocci's position untenable. Palocci would likely resign rather than remain in the job should: 1) events render him ineffective; 2) he be called to testify before one of the CPIs; or, 3) further damaging revelations surface. We do not believe, however, that Rousseff's comments indicate a serious effort on her part to change the basic thrust of the GoB's current sound economic policy. The debate thus far has been one of degree, i.e. by how much to over-perform the formal primary surplus target. It's a debate we can live with. End Summary and Comment.

Palocci Scandal Links - Cuba this time?

[1](#)3. (S) Palocci has been the subject of several sets of allegations involving kickbacks on municipal contracts let during his tenure as mayor of the city of Riberao Preto as well as charges of influence peddling by people close to him. The kickbacks allegedly financed off-budget PT party slush funds. In the last week, a new sensational allegation has been made that in 2002 Palocci, then Lula's presidential campaign coordinator, knew of and approved a USD 3 million Cuban Government campaign contribution to the PT party. Veja magazine (Brazil's leading news weekly) claims that Sergio Cervantes, a Cuban Intelligence Officer formerly assigned to the Cuban Embassy in Brazil, gave USD 3 million in cash to Ralf Barquete and Vladimir Poletto, a claim based in part on interviews with Poletto and Rogerio Buratti. At the time Barquete, who died of cancer last year, was a special assistant to Palocci and the other two individuals were senior figures in the municipal government of Riberao Preto. The money reportedly was flown from Brasilia to Sao Paulo on a private plane belonging a businessman, Roberto Colnaghi, reputed to be close to Palocci. The pilot of the aircraft confirmed to the magazine that he had flown Palocci's aide with three boxes, allegedly containing the cash, on or about the dates mentioned in the Veja story.

[1](#)4. (SBU) In testimony before the Congressional Investigatory Committee (CPI) on Bingos on November 10, Poletto recanted the Cuba cash story, claiming that he had been drunk when interviewed by the Veja reporter. Buratti likely will be called to testify before the CPI as well. No physical or documentary evidence has yet surfaced publicly to

substantiate the accusations. Palocci has threatened on multiple occasions to resign should the CPI call him to testify about his or his brother's activities (see below), a threat that, if carried out, would force the Congress to deal with the potential financial market repercussions of his departure. A compromise was worked out to have Palocci appear before the Senate Economic Affairs Committee (on November 22) instead a CPI and to respond to some limited questioning about the allegations against him. The deal, however, has not put to rest all opposition calls that Palocci be called to testify before a CPI or media questions about the viability of his continued tenure as finance minister.

15. (U) Other sets of accusations have been made against Palocci, which we outline briefly below:

Case 1) Interbrasil Seguradora) Interbrasil Seguradora donated money to the PT campaign in Goias. After the elections, Interbrasil Seguradora won government contracts worth R\$ 4.6 billion. Andre Marques da Silva, president of Interbrasil Seguradora had a close relationship with Adhemar Palocci, brother of FINMIN Antonio Palocci and head of PT accounting/finance in Goias. Allegedly, Antonio Palocci was a facilitator in helping Interbrasil Seguradora win public bids and obtain government contracts.

Case 2 - Leao and Leao) During his 2nd term as Mayor of Ribeirao Preto, in 1999, Palocci's municipal administration awarded government contracts to waste management company Leao and Leao. The trash company is claimed to have been given preferential treatment in these public contract bids. Leao and Leao was one of the major contributors to the PT campaigns in the State of Sao Paulo. The main actor in this case is Palocci's municipal planning secretary, Rogerio Buratti, who has said that he had the approval of Palocci to work with Leao and Leao. Buratti claims that kickbacks from Leao and Leao were channeled via the now-deceased Ralf Barquete to PT party Treasurer Delubio Soares. One of the CPIs investigating the interlocking scandals has just recommended that Soares be indicted for illegal fundraising activities (not involving the Cuba connection).

Case 3) Banco Prosper. Raul Barquete and Vladimir Poletto were both municipal secretaries when Palocci was Mayor of Ribeirao Preto. Barquete and Poletto allegedly were paid consultancy fees by private companies for helping them obtain loans from the National Social and Development Bank (BNDES), all done using Palocci's political influence.

Other Cases - There are several other cases about which less information has surfaced or which have an indirect Palocci nexus: a) Palocci's former aide Rogerio Buratti allegedly tried to extort money from U.S. company G-Tech in order to obtain a federal lottery contract renovation; b) The city of Ribeirao Preto in 2002 carried out a questionable Reals 1.25 million tender for a particular peas and tomato sauce, made exclusively by one company, to be included in basic food baskets for the poor; c) other Ribeirao Preto city contracts for social and infrastructure projects are under investigation by State of Sao Paulo prosecutors for alleged overbilling and payment of questionable consultancy fees; and, d) the Brazilian Reinsurance Institute (IRB), which Palocci supervised as Finance Minister, has been accused of corruptly awarding bids and jobs.

Rousseff Piles On

16. (U) In an interview published by major daily Estado de Sao Paulo on Wednesday November 9, Lula Chief of Staff Rousseff roundly criticized a proposal advanced jointly by Bernardo and Palocci to cap current expenditures and maintain a high primary surplus into the medium term. The proposal was based on a study by the GoB-linked Institute for Applied Economic Research (IPEA) that suggested these steps would allow: 1) increases in public investment; 2) reductions in the GoB borrowing requirement, thus allowing interest rates to fall; and, 3) eventual reductions in the tax burden. Rousseff mocked the proposal as "rudimentary." She said it would not be debated within the administration and appeared frustrated with the Finance Ministry's pursuit of ever-higher primary surpluses. On Friday November 11, Vice President Alencar seconded Rousseff's criticisms.

17. (SBU) This surplus versus spending debate has been raging within the administration for a while. Recently, Fazenda Secretary General Portugal told Emboffs that his Ministry

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unofficially had raised the primary surplus target above 4.25% of GDP, knowing that they would receive political flak if they attempted to do so formally. Meanwhile, worried about surging non-discretionary expenditures, influential opposition figures are flogging proposals for a constitutional amendment requiring a zero nominal deficit --

i.e., a gimmick to keep spending under control. (Note: the GoB ran a 4.61% of GDP primary surplus in the first three quarters of 2005, well above the formal target of 4.25%. This greater savings made little dent in overall debt levels, however, because interest expenses were higher due to the cycle of monetary policy tightening earlier this year. End Note.)

18. (SBU) Rousseff, while not questioning the necessity for the 4.25% target, called for the GoB to use revenues in excess of the target to finance investments. While there was frequent tension on fiscal policy between Palocci and Rousseff's predecessor, Jose Dirceu, the GoB always kept these disagreements in the background. Rousseff's public criticism reportedly has stung both Palocci and Bernardo and made Palocci consider resigning unless Rousseff publicly retracts her comments.

Markets "Serene"

19. (SBU) In a November 8 conversation, the Chief Economist at Credit Suisse First Boston (CSFB) told Emboff that the markets, still focused on Brazil's solid fundamentals, largely had taken in stride the allegations that Palocci knew of Cuban campaign contributions and the separate Palocci threat to resign if called to testify in the Interbrasil Seguradora case. He emphasized that Congress was treading carefully with regard to Palocci in order to insulate the economy from the scandal goings-on. The allegations against Palocci's brother, the CSFB economist said, have been refuted by Electronorte, the supposed source of the crooked contracts. And the markets do seem to be nonplussed by these events: Standard and Poors changed its rating outlook for Brazilian debt to positive and the Real is trading at three-year highs against the dollar, almost reaching 2.17 in early trading November 10. A JP Morgan economist echoed these points in a November 10 conversation with Econoff, arguing that since Palocci's economic policy was Lula's only success, there was little danger that Lula would let him go. He surmised that Palocci was in a more secure political position now than when the first set of accusations against him (the Leao and Leao allegations) were made on August 19 (ref C).

CHICOLA